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No. 72

Supreme Court of the United States

October 1954 Term

FRANK COSTELLO,

Petitioner,

—v.—

UNITED STATES OF AMERICA.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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To the Chief Justice of the United States and the Associate Justices of the United States Supreme Court:

Petitioner respectfully asks this Court to issue a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit which affirmed his conviction for violation of §145(b) of Title 26, United States Code, with respect to Counts III and IV of the indictment.

(a) The Opinions Below

The opinions of the court below have not yet been officially reported. Copies are hereto annexed (See pp. 27-50, *infra*).

(b) Statement of Grounds of Jurisdiction

(i) The judgment of the Court of Appeals was rendered and entered on April 5, 1955.

(ii) Timely application for rehearing was made on April 12, 1955, and was denied on April 14, 1955.

(iii) The jurisdiction of this Court is invoked pursuant to 18 U. S. C. Rule 37; and 28 U. S. C. §1254.

(c) Questions Presented for Review

1. May a defendant be required to stand trial and a conviction be sustained where only hearsay evidence was presented to the grand jury which indicted him.

2. Did the trial court commit prejudicial error in refusing to permit petitioner to introduce in evidence tax assessments and to cross-examine a government agent so as to establish that, during the period immediately preceding the indictment years, the government had assessed petitioner for substantial additional income taxes, on a claim that he had had substantial earnings for those years in an amount sufficient to explain the alleged unreported income for the indictment years.

3. Did the government make out a case for submission to the jury under the net worth-expenditures theory when the opening net worth statement erroneously omitted substantial amounts of currency in the possession of the defendant.

4. Did the government make out a case for submission to the jury under the net worth-expenditures theory where there was no evidence of a "likely" source of income attributable to the particular tax years under consideration.

5. Does the government make out a case for submission to the jury under the net worth-expenditures theory unless every element of the case is proved beyond a reasonable doubt.

6. Did the trial court commit prejudicial error in permitting proof of numerous and substantial expenditures by petitioner's wife without any evidence that she was spending money earned by him during the indictment years; and in refusing to charge that the jury could not convict unless it found that the money was received from him during those years.

7. Was the charge of the trial court adequate on the subject of reasonable doubt, particularly in its failure to advise the jury it must find that each element of the offense existed beyond a reasonable doubt.

8. Did the court below commit prejudicial error in affirming the conviction of petitioner for the years 1948 and 1949 and refusing to grant a new trial after ruling that the evidence required an acquittal for the year 1947 on the ground that the opening net worth statement relied on by the government had erroneously failed to credit petitioner with substantial amounts of currency.

(d) Statutes Relied On

The statute under which petitioner was prosecuted reads as follows:

Section 145(b), Title 26, United States Code:

"Any person * * * who willfully attempts in any manner to evade or defeat any tax imposed by this

chapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than five years, or both, together with the costs of prosecution."

(e) Statement of Case

1. Petitioner was indicted for wilful evasion of income taxes for the years 1946 to 1949 (9a-12a).* The government claimed that the income for those years had been understated by over $100,000. Petitioner was acquitted by the jury (7a) for the year 1946, which involved only his separate return; he was convicted for the years 1947, 1948 and 1949, which involved joint returns with his wife. He was given the maximum sentence of five years on each count, to run concurrently, and was also sentenced to pay the maximum fine of $10,000 on each count and to pay the cost of the prosecution (1889a).

Before trial petitioner moved to examine the grand jury minutes and to dismiss the indictment on the ground that there was no lawful evidence to support it. At the trial petitioner established that not a single one of the witnesses who there testified to transactions with himself or his wife had appeared before the grand jury and that the only persons who had there appeared were government agents. At the end of the government's case petitioner again moved to dismiss the indictment on the ground that it now appeared that there was no competent evidence before the grand jury (1651a). The motion was renewed at the end of the entire case (1782a). The court below, while finding

* The references are to the appendix in the court below.

that the grand jury acted only on hearsay, held that this type of evidence should not invalidate an indictment (p. 47, *infra*).

2. At the trial the prosecution proceeded upon the basis of the net worth-expenditures method. It started with the government's reconstruction of the net worth of petitioner and his wife as of January 1, 1946 (Exh. 363, Exh. Vol. p. 42). Included were bank accounts, but no items of currency although in statements made in 1937 and in 1939 petitioner had stated that he was a gambler and, for the purpose of that occupation, kept on hand large amounts of currency ranging, at that time, from $30,000 to $40,000 (Exh. Vol. pp. 9, 26).

In an attempt to justify its failure to include currency on hand at the beginning of the indictment years the government introduced a mass of material, starting with some statements made by petitioner to a revenue agent in October 1937 (Exh. 23, Exh. Vol. pp. 1-10), which the government has characterized as a net worth statement, but which consists merely of answers to various questions. The government then attempted to trace the expenditures of petitioner and his wife from 1937 through 1945 and compared these with their reported earnings, coming up with an excess of expenditures (including investments) of a considerable amount. This material is summarized in Exhibit 362 (Exh. Vol. pp. 33-41). The same method was continued during the indictment years, summarized in Exhibit 363 (Exh. Vol. pp. 42-52).

The great preponderance of witnesses testified only to expenditures by petitioner's wife; these aggregated over $100,000 during the four indictment years.

These exhibits show that petitioner and his wife, commencing at least in 1943, were spending and investing on a lavish scale.*

During the indictment years the tax returns of petitioner and his wife showed income from several sources (Exh. 363(f), Exh. Vol. p. 52) aggregating from an annual low of $33,614 to a high of $53,259.

The government conceded that it had no proof that petitioner or his wife had received any money from any of these sources beyond what he and his wife actually reported (1395a, 1396a). But in the court below the government argued in its brief that there were three "likely" sources: gambling; Louisiana Mint Company, which operated slot machines; and Beverly Country Club, which operated a restaurant and gambling house.

Petitioner contended that there was no basis for any inference that he had received any undisclosed income. The last mentioned concern was a corporation which he neither controlled nor operated (403a, 404a) and the only evidence was that it had made no distribution of profits (408a). Louisiana Mint Company was a partnership which stopped operations in 1946 (366a, 370a). Consequently there was no basis for any contention that moneys petitioner might have received from it (and there was no proof

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* Exhibits 362(c) and 373(d), Exh. Vol. pp. 37, 48, show the following expenditures:

1940	$23,780
1941	17,321
1942	17,428
1943	57,281
1944	63,861
1945	73,453
1946	77,693

that he did receive any not reported)* were accountable, taxwise, during 1947, 1948 or 1949.

With respect to the claim that the likely source might have been gambling, petitioner pointed to the absence of any proof that he had any earnings from gambling activities except to the extent that the 1948 and 1949 tax returns showed "miscellaneous" income,** which his attorney testified constituted winnings from wagers.

The court below adverted also to certain amounts reported in petitioner's returns which the testimony showed to have been received for keeping bookmakers away from a particular racetrack. But there was no evidence that petitioner had performed similar services for anyone else or had received any more than was reported.

3. To offset the government's attempt to show that petitioner had no currency reserve on hand on December 31, 1945 petitioner, on cross examination of one of the agents (1512a), sought to show that the government had assessed him with additional income of $292,000 for the years 1941-1945 and offered in evidence the assessments which had been made (Exhs. DDD-HHHH for Iden.; Exh. Vol. pp. 132-139). The significance of these assessments is that, for the longer period, 1937-1945, the government had shown "excess" expenditures of only $202,800 (Exh. 362, Exh. Vol. p. 33). Thus an excess of $90,000 remained available after January 1, 1946. It is true that the government argued that these assessments for the earlier period were

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* It should be noted that a substantial amount of income ($19,335.25) from Louisiana Mint Company was reported for 1946, but none after that (Exhibit 303(f), Exh. Vol. p. 52).

** $9,500 for 1948 and $16,300 for 1949 (Exh. Vol. p. 52).

likewise based on the net worth-expenditures method, so that there was no basis for an inference that additional money was in fact available (1521a-1527a). But there was no evidence to support that argument—the witness Leath merely having expressed an opinion not based on personal knowledge. The trial court then rejected the offer of the assessments (1767a-1769a).

In the court below this ruling was affirmed on the theory that, although the evidence was relevant, it was within the discretion of the trial court to reject it because it might confuse the jury (pp. 36, 37, *infra*).

4. The court below reversed the conviction of petitioner under Count II for the year 1947 because it accepted petitioner's contention that the opening net worth statement was incorrect, having omitted any currency reserve. The court concluded that the evidence required a finding that there was a substantial reserve of at least $40,000; therefore it would have absorbed the excess attributed to petitioner for the years 1946 and 1947.* But the court expressed the view that it would be "quixotic" for the jury to have found that the reserve was large enough to absorb the excess attributed to petitioner for the years 1948 and 1949.

With respect to this ruling of the court below (and only with respect to that) petitioner asked for a rehearing.

* Judge Hand's suggestion that the acquittal for 1946 rested on the jury's finding that there was currency on hand sufficient to absorb only that year's excess ignores the much greater probability that it rested either on the insignificant amount of net income involved ($1541.) or, as the government contended in its brief below, on the allocation of a disputed Louisiana Mint payment (See 1616a-1620a).

Petitioner contended that it was for the jury, not any court, to determine the size of the currency reserve and that he was entitled to a new trial so that he could get the benefit of a determination by a jury instructed that the government's claim that there was no such reserve was wrong. That application was denied without opinion.

(f) Jurisdiction of the Court Below

The District Court had jurisdiction under 26 U. S. C. §145(b). The Court of Appeals had jurisdiction under 28 U. S. C. §1291.

(g) Reasons Relied On

As to Question 1

The court below has rendered a decision in conflict with decisions of another Court of Appeals in relation to the validity of an indictment founded only on hearsay evidence, which is an important question of federal law which has not been but should be settled by this Court.

The Constitution (Amendment V) requires that no person shall be "held to answer for" an infamous crime "unless on a presentment or indictment of a Grand Jury".

We have been unable to find any case which takes the position adopted here by the Court of Appeals that a conviction may be upheld when the indictment was based wholly on hearsay evidence.

The opinion of Judge Hand recognizes that the question of the validity of such an indictment is "still undecided"

by this Court. In his concurring opinion Judge Frank expressed doubts but said:

> "However, because of my esteem for Judge Hand's wisdom, I reluctantly concur, with the hope that the Supreme Court will review our decision and consider the question."

The Court of Appeals for the Eighth Circuit has reached a contrary result in *Nanfito* v. *United States*, 20 F. 2d 376, and *Brady* v. *United States*, 24 F. 2d 405.* [Judge Hand cited these cases and expressed his disagreement with their holding (p. 43, *infra*)]. In the second of these Judge Phillips said (p. 407):

> "It is the settled law of this circuit, we think, that an indictment will be quashed, where there was either no evidence whatever, or no competent evidence of the offense charged, presented to the grand jury."

The right to challenge an indictment for lack of competent evidence has also been recognized in the Fifth Circuit: *Duarte* v. *United States*, 171 F. 2d 971.

Similar views have been expressed by various other judges. In *United States* v. *Kilpatrick*, 16 Fed. 765, (W. D. N. C. 1883) Judge Dick granted a motion to quash an indictment because based on incompetent evidence and said (p. 771):

> "Investigations before grand juries must be made in accordance with the well-established rules of evidence * * *."

* *Banks* v. *United States*, 204 F. 2d 666 (8th Circ., cert. den. 346 U. S. 857; order vacated 347 U. S. 1007; judgment vacated and case remanded 348 U. S. 905) is not inconsistent with these earlier decisions from the same Circuit. For in the *Banks* case the Court of Appeals held that the challenged evidence before the grand jury was not incompetent.

In *United States* v. *Bolles*, 209 Fed. 682 (W. D. Mo. 1913), Judge Youmans in the course of an opinion denying a petition to allow certain persons to appear before a grand jury said (p. 684):

> "'To warrant the return of an indictment it should be based on competent legal evidence, such as is legitimate and proper before a petit jury.'"

In *United States* v. *Rubin*, 218 Fed. 245 (D. Conn. 1914), Judge Thomas quashed an indictment based on hearsay evidence. He quoted (p. 248) from a charge by Mr. Justice Field, sitting in Circuit, given in 1872 to a grand jury (apparently the same charge referred to in the *Bolles* case, *supra*, at p. 688, as reported in 30 Fed. Cas. No. 18,255, p. 992, and in the *Kilpatrick* case, *supra*, at p. 771, as reported in 5 Amer. Law J. 259):

> "'In your investigations you will receive only legal evidence, to the exclusion of mere reports, suspicions, and hearsay evidence.'"

And Judge Thomas went on to say (p. 248):

> "This general proposition of law relating to the kind and character of evidence proper for consideration by the grand jury has been generally followed in the better considered cases in the federal courts. Under this rule hearsay evidence is improper and an indictment founded upon it is invalid."

Against this background of judicial authority the court below rested its decision on its dislike of the hearsay rule

generally* and on one of Dean Wigmore's characteristic comments (§2364, Vol. VIII, p. 730). But it is noteworthy that this comment is, so to speak, an aside in a discussion of the manner in which the conduct of a grand jury may be attacked under the general heading of "Privileged Communications" and therefore is not a considered discussion of the basic principle itself.

Surely in this setting the decision of the court below should be reviewed by this Court.

As to Question 2

The court below has rendered a decision in direct conflict with a decision of another Court of Appeals in refusing to receive in evidence tax assessments for the years immediately preceding the indictment years and refusing to permit cross-examination as to those assessments.

In *Ford* v. *United States*, 210 F. 2d 313; the Court of Appeals for the Fifth Circuit reversed a net worth conviction because the trial court refused to permit cross examination of a government agent to show that the government had assessed defendant for a large tax deficiency for a year preceding that covered by the indictment. The Court said at page 319:

> "We think that the testimony sought to be elicited was relevant for the purpose stated by defendant's

* The Court's real objection to barring an indictment based only on hearsay appears to be dissatisfaction with the operation of what had been the rule permitting hearsay if buttressed by some direct evidence. Since courts have often held very slight additional evidence to be enough, of what value is the basic rule against allowing hearsay, suggests Judge Hand. He might as well reject the rule against allowing convictions on uncorroborated confessions because often courts have required too little corroboration. (See *e.g. Smith* v. *United States*, 348 U. S. 147; *United States* v. *Calderon*, 348 U. S. 160.)

> counsel, 'to show cash funds available for expenditures.' Receipt of income in 1944 might go to establish resources available at the beginning of 1945, and to rebut the inferences to be drawn from the witness' direct testimony. Clearly, we think the defendant's right of cross-examination of this witness was improperly restricted, if not summarily denied. See Johnson v. United States, 318 U. S. 189, 196, 63 S. Ct. 549, 87 L. Ed. 704; Alford v. United States, 282 U. S. 687, 692, 51 S. Ct. 218, 75 L. Ed. 624."

In the case at bar the court below, without any mention of this case (although it was discussed fully in petitioner's brief), reached a contrary conclusion on the sole ground that petitioner should have offered to supplement the evidence offered by showing what, if any, part of the apparent surplus had been spent.

But in reaching that conclusion the court below overlooked the fact that this issue arose upon the cross examination of the government's witness Leath, who had testified on direct with regard to the expenditures of petitioner and his wife during the period preceding the indictment years. The object of the cross examination was to show that according to calculations made by the Treasury Department petitioner and his wife were said to have earned an amount nearly $100,000 larger than the figures to which the agent had testified. This in effect was a lead which the government had which was not accounted for and which it was under a duty to explain (see *Holland* v. *United States*, 348 U. S. 121, at p. 135 ff). The government, of course, may have been able to explain the matter, but certainly the defense had the right to call attention to the

discrepancy in the figures which the government at various times had used.

We submit that the conflict between the Courts of Appeal for the Fifth and the Second Circuits requires intervention by this Court.

As to Questions 3, 4, 5, 6 and 7

The court below has decided a federal question in a way that conflicts with applicable decisions of this Court, by ruling that the evidence was sufficient to justify a conviction for income tax evasion under the net worth-expenditures theory.

This Court, in the case of *Holland* v. *United States*, 348 U. S. 121, pointed out the dangers implicit in prosecutions under the net worth-expenditures method of proof and laid down rules for the guidance of the courts in considering such cases. This Court stressed (a) the importance of a correct starting point; (b) the necessity for proof that the excess attributed to an accused came from income received in the year to which it is attributed; and (c) that every element of the offense be proved beyond a reasonable doubt. We submit that the court below failed to give due heed to those admonitions.

(a) *The Starting Point*

Judge Hand recognized that the beginning net worth was vital and said it would be "falsified" to the extent that any currency on hand would be omitted and that the computation for later years would "fall" with it. But we respectfully submit the court usurped the function of the jury in deciding that the amount of currency erroneously

omitted from the opening statement was enough to absorb the excess attributed to petitioner for 1946 and 1947 but not enough to absorb the excess attributed to him for 1948 and 1949. Surely petitioner was entitled to a jury determination on that issue.

In reaching his conclusion Judge Hand referred to appellant's testimony before the grand jury in 1939 that he had $40,000 currency on hand then. But it is evident that at that time petitioner's financial circumstances were not nearly as good as they later became. As we have already pointed out his scale of living increased progressively from 1943 onward. It could therefore have been argued with great persuasiveness to a jury, based on the ruling as a matter of law that the government's starting point was inaccurate, that the amount of currency kept on hand by petitioner had likewise progressively increased. Such an argument would have been supported, moreover, by the continuing large transactions involving currency during the intervening years.* Certainly petitioner should not be foreclosed from an opportunity of persuading a jury that the amount of currency actually on hand was sufficient to absorb the entire amount of the excess claimed by the government for all of the prosecution years.

Indeed, the jury might well have rejected many of the items relied on by the government** and thus materially

* In 1944 petitioner paid more than $42,000 in cash in large sums (989a, 990a) and in addition lost $27,200 in cash in a taxicab (1696a). In 1945 he made a payment of $9,500 in cash (994a), in 1947 an investment of $10,000 was made in cash (1004a, 1008a).

** Among the items the jury might have rejected are those aggregating $29,000 which petitioner claimed were not proven, as well as Mrs. Costello's expenditures.

reduced the excess which the government fixed at around $100,000. A much smaller currency reserve might then have sufficed to wipe this out. Under the Sixth Amendment a defendant has the right to have these matters determined by a jury.

Judge Hand has, moreover, dealt with the case on the assumption that only petitioner's possible currency reserve was involved. But account must be taken also of his wife's having had currency on hand. The proof showed that during all the indictment years, and for some time before, she had three safe deposit boxes—one with the Port Washington Safe Deposit Co. (263a) and two with the Corn Exchange Bank (895a, 896a). It is not to be assumed that these were empty. And the matter is not disposed of by pointing out that she had no income, for the record shows that she had investments.* She had $20,000 in 1948 with which to buy lots in Florida (1008a; 1009a, Exh. 363a, Exh. Vol. p. 43). And she may well have had *other* property that was not income producing but was from time to time reduced to cash.

(b) *Attribution to the Indictment Years*

This Court, in the *Holland* case, warned that the existence of excess moneys did not warrant the inference that they were income attributable to the indictment year. While this Court pointed out that proof of a "likely" source would be sufficient to show that the moneys were taxable, it nevertheless particularly stressed the necessity

* In addition to the Florida lots mentioned in the text she was the owner of the Crescent Music Co. interest of about $47,000 (335a, 336a, Exh. 363b, Exh. Vol. p. 44).

for allocation where the indictment covered more than one year.

We submit that the court below misconceived the purport of this Court's ruling with respect to "likely" sources and utterly failed to heed this Court's warning that the increase in net worth must be allocated to the appropriate tax year. For there is here no basis whatever upon which the jury could have found that the increments attributed to petitioner for 1948 and 1949 were not the results of prior earnings. It is significant in that connection that during all this period (1946-1949) and even before the indictment years, he was living in a grand manner. His expenditures exceeded $50,000 in 1943 and approximated $75,000 in each of the succeeding years.

In support of his conclusion that there were likely sources Judge Hand referred to petitioner's interest in slot machines and juke boxes. This appears to accept the argument of the government in the court below with respect to the Louisiana Mint Company. But that concern was a partnership which ended its operations in 1946 (366a, 370a). Therefore petitioner could not have received money from the juke boxes it operated for which he was obligated to account income tax wise in 1948 or 1949.

The fact that petitioner received money for the use of his influence which he voluntarily reported in his tax returns surely cannot lay the foundation for an inference beyond a reasonable doubt that he received unreported money from other or similar sources in those years. The same observation applies to his possible winnings from wagers. In 1948 and 1949 he reported such winnings. There was not the slightest basis other than conjecture

or suspicion that he actually had won more. The conclusion reached by the court below on these points is at variance with that reached by Judge Yankwich in *United States v. Clark*, 123 F. Supp. 608, at p. 616, where he held that no inference could be drawn from gains revealed.

Moreover, in discussing gambling as a possible likely source of the excess of $100,000 attributed to petitioner by the government, Judge Hand said: "Gambling is an occupation with indeterminate possibilities that might well have brought in more than $100,000 in a single year * * *." If by this Judge Hand meant to say that a jury could so speculate, then it is as consistent with the presumption of innocence to have come to the conclusion that this $100,000 was won by petitioner as a gambler in one or more of the years before the indictment period as that it was won partly in 1948 and partly in 1949. In those years petitioner had, in his tax returns, reported income which was testified to as being winnings from wagers (1080a; 1081a). That was the only evidence in the record with respect to any earnings from gambling during the years under indictment. To hold, therefore, that the jury could beyond a reasonable doubt conclude that petitioner had earned such large additional sums from gambling during either of those years would be to permit a conviction based on speculation in complete disregard of this Court's admonition in the *Holland* case.

Here there was no proof that the alleged unaccounted for funds were derived from taxable sources or that they were received by petitioner in any one year, much less that they were received by him in 1948 or 1949. Even if the proof might have permitted an inference that the funds

were derived from taxable sources it does not, independently, permit any inference as to the year in which they were received. To permit a finding of guilt would be to build inference on inference. As was recently said in *Sapir v. United States*, 216 F. 2d 722, affirmed in this respect 348 U. S. 373:

> "It is well settled that an inference cannot be predicated upon another inference. Presumption cannot be superimposed upon presumption to reach a factual conclusion" (citing *Rosenberg* v. *United States*, 120 F. 2d 935, 937).

See also

> *United States* v. *Ross*, 92 U. S. 281, 283;
> *Chicago, Milwaukee & St. Paul Ry.* v. *Coogan*, 271 U. S. 472, 477.

In this connection it should be borne in mind that the case at bar differs from the *Holland* case, where the proof showed a sharp increase in expenditures during the indictment period and a particular disclosed income source was proven capable of producing a much larger income than was reported. Here, during the five years immediately preceding the indictment years the expenditures of petitioner and his wife were very large and included large cash transactions. And there was no proof that more was available during the indictment years from any disclosed source than was reported.

This issue is sharpened by the circumstance that so large a part of the expenditures proved by the government were expenditures and investments by petitioner's wife. On this subject the court was asked to charge (No. 19, 1843a) that her expenditures could not be considered unless

the jury was satisfied that the money used came from petitioner and represented income chargeable to petitioner in the year in which it was spent. This the court did not charge. Instead it advised the jury only that the expenditures and investments by petitioner's wife could be considered if the money had been supplied by petitioner (1857a). No regard was given to when that money may have been earned or even how much earlier than the indictment years it may have been given to her. An express exception was taken to the refusal to charge Request No. 19 (1863a).

In the court below the error of the trial court was perpetuated (p. 37, *infra*). For there Judge Hand limited his consideration to the question of whose money it was, giving no consideration to whether the money represented income of petitioner during any of the indictment years.

(c) *The Reasonable Doubt Requirement*

We submit that the court below has not properly applied this Court's admonition that each element of the offense must be established beyond a reasonable doubt. For it approved a charge that contained no such injunction to the jury. And it upheld the trial court's refusal to grant defense motions for a directed verdict on the ground that the quantum of evidence is the same in criminal as in civil cases and that only the jury is concerned with the question of reasonable doubt. Judge Hand said:

> "Finally, it should be remembered that, as in all criminal prosecutions, the prosecution makes out a sufficient case to go to the jury, if the evidence

would have been enough in a civil action; the only difference between the two is that in the end the evidence must satisfy the jury beyond any reasonable doubt." (p. 29, *infra*).

In support of this view Judge Hand cited a large number of Second Circuit cases.* But Judge Frank pointed out that other courts had held otherwise and expressed the opinion that this Court should consider the matter (pp. 49, 50, *infra*).

In addition to the cases cited by Judge Frank we call the Court's attention to *Chicco* v. *United States*, 284 Fed. 434, 437 (4th Cir. 1922). There Judge Groner held that a verdict should have been directed in favor of one of the defendants because "there was altogether lacking that degree of certainty of guilt which would alone justify a conviction."

And in *Lempie* v. *United States*, 39 F. 2d 19, 21 (9th Cir. 1930), Judge Dietrich reversed a conviction because the evidence "was insufficient to convince a fair-minded man beyond a reasonable doubt of the truth of the charge," and the facts "do not at all exclude the reasonable theory of defendant's innocence".

To like effect are *Harjiey* v. *United States*, 13 F. 2d 114 (8th Cir. 1926); *Benn* v. *United States*, 21 F. 2d 962 (9th Cir. 1927).

A very recent instance is *Sapir* v. *United States*, 216 F. 2d 722. There the Court of Appeals for the Tenth Circuit

* Judge Hand also cited *Pierce* v. *United States*, 252 U. S. 239, but the views there expressed would seem to be inconsistent with more recent decisions of this Court such as *Ward* v. *United States*, 344 U. S. 924, and *Sapir* v. *United States*, 348 U. S. 373.

held that a motion for judgment of acquittal should have been granted because the evidence was "insufficient to warrant the jury in finding beyond a reasonable doubt" the existence of one of the essential elements of the crime. It is interesting to note that the modified direction of the Court of Appeals for a new trial was vacated by this Court (348 U. S. 373) and the original direction calling for dismissal of the indictment reinstated. The position taken by the court below in the case at bar is clearly inconsistent with that ruling.

Surely there is a duty imposed on the court, as well as on the jury, not to permit a conviction if the evidence fails in any essential respect to support the prosecution beyond a reasonable doubt. In New York the Court of Appeals has recognized that obligation and often set aside convictions on that ground:

People v. *Gaskin*, 306 N. Y. 837;
People v. *Moscarelli*, 303 N. Y. 923;
People v. *Richardson*, 287 N. Y. 563.

These cases all recognize the importance of the presumption of innocence in weighing the evidence in a criminal case. No such presumption operates in civil litigation. This Court should, therefore, consider whether or not a trial court does not have a greater responsibility in a criminal than in a civil case in ruling on a motion for a directed verdict.

In this connection we call the Court's attention to *Ward* v. *United States*, 344 U. S. 924 where it reversed an affirmance (195 F. 2d 441) which had rested on the ground that there was enough evidence to go to the jury.

As to Question 8

The court below has so far departed from the accepted and usual course of judicial proceedings, by refusing a new trial although finding substantial error in the submission of the case to the jury, so as to call for an exercise of this Court's power of supervision.

We have already adverted to the fact that the court below affirmed the convictions under the third and fourth counts despite the fact that it had accepted petitioner's contention that the crucial starting net worth statement, the very cornerstone of the prosecution's arch, was incorrect. This, we submit, was usurpation by the court of the function of the jury as well as a disregard of the admonitions of the *Holland* case.

Moreover the case is, in effect, in the same posture as where an appellate court finds that an issue has been submitted to a jury that should not have been. In such situations a general verdict will be set aside, since the appellate court cannot determine whether or not the verdict was based on the improper issue (*Stromberg* v. *California*, 283 U. S. 359; *Williams* v. *North Carolina*, 317 U. S. 287).

So here, no appellate court can determine how a jury would have acted had it been instructed that it must credit petitioner with a substantial amount of currency in the crucial beginning net worth statement.

Such a new trial is all the more called for here because the court instructed the jury that it might not include any of Mrs. Costello's expenditures unless it found that the money she spent was petitioner's money (1857a). The jury may therefore have rejected many of the expendi-

tures made by Mrs. Costello in each of the years 1947, 1948 and 1949 because of the lack of showing that the source of these was petitioner's own money, and nevertheless convicted petitioner because there was left unexplained in each of those three years some substantial amount. No one can say, however, whether the aggregate of the amount so found by the jury for those three years was more or less than $40,000. Even if the figure had somewhat exceeded $40,000, a jury might have acquitted because the excess would have been so insubstantial as not to have justified an inference of willful evasion of the tax. In addition there are also, of course, the disputed items previously referred to which amount to $29,000. All of these considerations underline the necessity for a new trial here.

In *Kotteakos* v. *United States*, 328 U. S. 750, in reversing a conviction, Mr. Justice Rutledge said at page 764:

> "* * * In criminal causes that outcome is conviction. This is different, or may be, from guilt in fact. It is guilt in law, established by the judgment of laymen. And the question is, not were they right in their judgment, regardless of the error or its effect upon the verdict. It is rather what effect the error had or reasonably may be taken to have had upon the jury's decision. The crucial thing is the impact of the thing done wrong on the minds of other men, not on one's own, in the total setting. Cf. *United States v. Socony-Vacuum Oil Co., supra*, at 239, 242; *Bollenbach v. United States, supra*, 614.
>
> "This must take account of what the error meant to them, not singled out and standing alone, but in relation to all else that happened. And one must

judge others' reactions not by his own, but with allowance for how others might react and not be regarded generally as acting without reason. This is the important difference, but one easy to ignore when the sense of guilt comes strongly from the record.

"If, when all is said and done, the conviction is sure that the error did not influence the jury, or had but very slight effect, the verdict and the judgment should stand, except perhaps where the departure is from a constitutional norm or a specific command of Congress. *Bruno v. United States*, *supra*, at 294. But if one cannot say, with fair assurance, after pondering all that happened without stripping the erroneous action from the whole, that the judgment was not substantially swayed by the error, it is impossible to conclude that substantial rights were not affected. The inquiry cannot be merely whether there was enough to support the result, apart from the phase affected by the error. It is rather, even so, whether the error itself had substantial influence. If so, or if one is left in grave doubt, the conviction cannot stand."

So here, who can say how the jury would have reacted had it known that the government's starting point was faulty. The result reached by the court below is at variance with this Court's rulings. It should be reviewed.

CONCLUSION

It is respectfully submitted that the various questions raised are of such importance in the administration of the criminal law and particularly of the law relating to

income tax evasions that there should be an authoritative determination of the same by this Court. Accordingly, petitioner asks that this Court issue a writ to review the judgment of affirmance herein.

Respectfully submitted,

Osmond K. Fraenkel
Morris Shilensky
Joseph Leary Delaney
Counsel for Petitioner

APPENDIX

OPINION

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 83 OCTOBER TERM, 1954

Argued October 8, 1954 Decided April 5, 1955

Docket No. 23149

UNITED STATES OF AMERICA,

Appellee,

—v.—

FRANK COSTELLO,

Appellant.

Before: CLARK, *Chief Judge*,

L. HAND and FRANK, *Circuit Judges*.

On appeal from a judgment of conviction of the District Court for the Southern District of New York (McGohey, *J.*, presiding) for violation of §145 (b) of Title 26, U. S. Code.

ARTHUR GARFIELD HAYS for the appellant.
LLOYD F. MACMAHON for the appellee.

L. HAND, *Circuit Judge*.

The defendant, Costello, appeals from a judgment entered upon the verdict of a jury, finding him guilty upon three of four counts in an indictment under §145 (b) of the Internal Revenue Code (Title 26, U. S. Code); *i.e.* of

wilful attempts "to evade or defeat a large part of the income tax" for the years 1947, 1948 and 1949, "due and owing by him and his wife," by understating their joint net income tax. (The jury acquitted him on the first count—1946—, which was for understating his separate net income tax). Judge McGohey imposed a sentence of five years upon each of the three counts for 1947, 1948 and 1949 (to be served concurrently), and a fine of $10,000 on each count cumulatively, together with the costs of the prosecution—$4,111.38. On the appeal Costello raises six points, which we shall consider seriatim. First, he challenges the sufficiency of the evidence to prove that he and his wife had received more taxable income in the three years in question than he included in their joint tax returns for those years. Second, he asserts that it was error to refuse his offer in evidence of tax assessments against him for the years 1941-1945, which showed a higher net income received by him than the prosecution computed as his gross income for those years; and which were therefore relevant to show that he might have laid up a cash reserve on January 1, 1946. Third, that it was error to include his wife's expenditures as part of his own. Fourth, that the court erred in the admission of various pieces of evidence offered by the prosecution. Fifth, that the judge's charge to the jury was insufficient. Sixth, that the indictment should have been dismissed because no competent evidence was before the grand jury at the inquest.

The first question is the most important. The prosecution built up its case upon what has come to be known as the "net-worth method," which the Supreme Court has very recently accepted as permissible, though it must be applied with the greatest caution.* This method presupposes that the prosecution first proves what property the

* *Holland* v. *United States*, 348 U. S. 121.

taxpayer had at the beginning of the year in question and what he had at the end of it. To the remainder obtained by subtracting the first from the second it adds whatever sums it can prove that he spent in the year in question. That is the putative gross income for the year; and the remainder, after deducting the amount of gross income reported, is by hypothesis the unreported gross income. However, this is not enough, for it does not follow that all that the taxpayer expended was necessarily taxable income, or indeed income of any kind. Conceding something for the difficulty of establishing by impregnable proof how much was income, the Court is satisfied with "proof of a likely source, from which the jury could reasonably find that the net worth increase sprang." True, a "likely source" may not be the true source, so that it is necessary in addition to exclude the possibility that what he received did not come from gifts, inheritances or loans. Here too the Court does not exact precision, for, "where relevant leads are not forthcoming the Government is not required to negate every possible source of non-taxable income, a matter peculiarly within the knowledge of the defendant." Nevertheless, in the end the prosecution must "prove every element of the offense beyond a reasonable doubt, though not to a mathematical certainty." "The settled standards of the criminal law are applicable to net worth cases just as to prosecutions for other crimes. Once the Government has established its case, the defendant remains quiet at his peril. * * * The practical disadvantages to the taxpayer are lessened by the pressures on the Government to check and negate relevant leads." Finally, it should be remembered that, as in all criminal prosecutions, the prosecution makes out a sufficient case to go to the jury, if the evidence would have been enough in a civil action; the only difference between the two is that in the

end the evidence must satisfy the jury beyond any reasonable doubt.*

The prosecution's proof started with a supposed "net worth" at the beginning of the year 1946, made up of four items which, less liabilities, aggregate $250,000,** and among which there is no item of cash on hand. Concededly the "net worth" at the beginning of each year would be falsified to the extent that any such sum was omitted; and with it would fall the computations for later years. However, we will disregard this possibility for the time being; and proceed on the assumption that the figure for "net worth" was accurate. Next, the prosecution proved that either Costello or his wife made large purchases in each of the four "indictment years," varying from nearly $60,000 in 1948 to over $90,000 in 1949. Then it proved the "net worth" at the beginning of 1947, and subtracted it from that at the beginning of 1946, which resulted in a minus quantity ($8500). This it deducted

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* *Pierce* v. *United States*, 252 U. S. 239, 251, 252;
Matheos v. *United States*, 8 Cir. 192 Fed. Rep. 490, 494, 495;
Stout v. *United States*, 8 Cir. 227 Fed. Rep. 799, 801;
Hays v. *United States*, 8 Cir. 231 Fed. Rep. 106, 108, aff'd 242 U. S. 470;
Looker v. *United States*, 2 Cir. 240 Fed. Rep. 932;
Felder v. *United States*, 2 Cir. 9 Fed. (2) 872, 875;
United States v. *Rowe*, 2 Cir. 56 Fed. (2) 747, 750, 751;
Crono v. *United States*, 9 Cir. 59 Fed. (2) 339;
United States v. *Valenti*, 2 Cir. 134 Fed. (2) 362, 364;
United States v. *Feinberg*, 2 Cir. 140 Fed. (2) 592, 594;
United States v. *Andolsehek*, 2 Cir. 142 Fed. (2) 503, 504, 505;
United States v. *Cohen*, 2 Cir. 145 Fed. (2) 82, 86;
United States v. *Picarelli*, 2 Cir. 148 Fed. (2) 997;
United States v. *Greenstein*, 2 Cir. 153 Fed. (2) 550;
United States v. *Spagnuolo*, 2 Cir. 168 Fed. (2) 768, 770.
United States v. *Sherman*, 2 Cir. 171 Fed. (2) 619, 621;
United States v. *Weissman*, 2 Cir. 218 Fed. (2);
United States v. *McKee*, 2 Cir. 218 Fed. (2).

** Throughout we will use round figures.

from the sum of the purchases; and the difference between what remained and the amount returned as gross income by Costello it asserted to have been fraudulently concealed. He raises a number of objections to this computation in addition to the omission of a concealed cash reserve. One of these is the failure to show a "likely source, from which the jury could reasonably find that the net worth increases sprang." There was no difficulty in the case at bar in pointing to such a source. By his own admission Costello was a gambler, though he had no other occupation. He had substantial interests in "slot machines" and "juke boxes" in Louisiana companies; and these were not his only ventures, for he gambled in "horses, cards and fights"; and there was evidence that he received $30,000 for keeping bookmakers away from a race track for two years; which of itself showed him to have been a man of powerful undisclosed influence. Gambling is an occupation with indeterminate possibilities that might well have brought in more than $100,000 in a single year—the highest with which he was charged in the four "indictment years." If there were no accumulated reserve and no loans, gifts or inheritances, gambling and such payments as the $30,000 we have mentioned, were a "likely source" of the money that he spent during the year. To exclude the possibility that loans, gifts and inheritances might have contributed, the prosecution searched all likely records for inheritances and for gifts and found none. Similarly, it found no credits on the returns of either Costello or his wife for the payment of interest on loans. The same method was followed for each of the "indictment years"; and it fulfilled the tests laid down in *Holland* v. *United States*, *supra*. Upon any issue it is nearly always true that the party having the affirmative does not, and cannot, shut the door against every possible exception; and it would be idle to deny that there were no possible excep-

tions on the present occasion; but we cannot see how it can be doubted that a man, having no resources in loans, gifts or inheritances, could have spent what Costello did in these four years, unless it was out of his income or his wife's, or unless he had a cash reserve accumulated from past years. As to his wife's income, the evidence justified a finding that the money had not come out of it, except in 1946 when she was credited with about $16,000 gross income, which she separately returned. In 1937 Costello had sworn that she had no income; in 1939 that, whatever money went into her bank account, he gave her; and in 1943 he told his lawyer that in 1941 she bought a motor car with his money, as well as "all the living expenses." In applying for insurance in 1940 she stated that she was supported by her husband. Furthermore, the prosecution traced many cheques received by him into her bank account and in 1943 two payments of Costello's estimated income tax were paid out of her account. From all this it was a permissible inference that in the four "indictment years" she had no separate income beyond what was credited to her in 1946.

Thus, the issue is narrowed to whether Costello had an accumulated cash reserve at the beginning of 1946, out of which the purchases might have come that were shown to have been made, and not declared. Since the aggregate of the net income omitted during the "indictment years," when computed as we have described, came to more than $100,000, perhaps it might have been fair to start with an assumption that no such hypothetical reserve covered the unreported income for at least the year 1949. However, the prosecution did not rely on such an assumption; it undertook to establish that Costello had no reserve whatever on January 1, 1946. It started with a statement of his "net worth" on October 18, 1937, the day of a sworn statement made by him to an official of the Tax

Bureau. On that day he said that he had a cash reserve of between $25,000 and $30,000 which he kept in currency. His bank deposits, investments and receivables, when added to this, made $45,600, from which was deducted loans of $6000. Thus, he started with a "net worth" on that day of substantially $40,000. As we have said, on January 1, 1946, a little over eight years later, this figure had become $240,000, making a gain of $200,000. To this the prosecution added purchases of $312,000, making $512,000; and, after deducting $6400 of non-taxable receipts and $302,500 of gross income declared, it asserted an unreported difference of $203,000. In addition it proved, as it had for the four "indictment years," that there was no record of any loans, gifts and inheritances.

In order to meet the possibility that Costello might have laid aside out of this a substantial cash reserve, it proved that he had allowed three judgments to remain unpaid, that he left a mortgage outstanding on his house; that he had allowed a loan on his life insurance to remain unpaid until 1946 when he paid less than half of it, and that he had borrowed $25,000 of a friend in 1946 and the same amount again in 1947. Finally, it proved that on February 24, 1947, he paid over $21,000 as penalty and interest upon taxes that had remained unpaid since 1930 and earlier. It must be owned that the combination of these facts makes it unlikely that there was any reserve left on January 1, 1946; and we should not hesitate so to assume, were it proper to make any inference against an accused from his failure to answer. Nevertheless, a man in Costello's position, whose affairs, as we can see, varied greatly up and down, might have allowed interest to run up, confident that in the end a turn would come; and have kept on hand a substantial cash reserve, prepared for a run of bad luck that would demand immediate calls for large payments. His situation was far from ordinary; and, as we have said,

in the past he had always kept such reserves in large amounts. Considering the admonition with which the Supreme Court has hedged about the "net worth method," we cannot therefore agree that the evidence, taken as a whole, justifies the inference that he had no reserve on January 1, 1946.

"On the other hand, the jury was warranted in setting a limit upon its possible size; and it is quite likely that this is exactly what they did do, when they voted to acquit on the first count. Costello's net income unreported for 1946 was only $1541, if we allow no cash reserve; that for 1947 was $36,730; and, if the jury assumed a reserve of $30,000 (the figure he gave in 1937), it would still be true that he would have understated the joint income for 1947. On the other hand, since his understatement of the joint income for 1948 was $35,245, and the aggregate understatement for 1946, 1947 and 1948 was therefore $73,524, it would have taken a reserve on January 1, 1946 of that size to deprive the verdict on the third count of all support in the record. Nothing suggests any reason why on January 1, 1946, he should have nearly doubled the maximum of $40,000 which had been enough six years earlier, especially when we remember the heavy liabilities that were rolling up in interest and penalties. In deference to the limitations imposed upon any use of the "net worth" method, we feel obliged to say that the evidence did not justify a verdict based upon the assumption that on January 1, 1946, there had not been a reserve of more than $30,000; or indeed of more than $40,000. On the other hand we also hold that, taking the evidence as a whole, it would be Quixotic for a jury to assume that on that day Costello had had a reserve of over $73,000. It follows that while there was not enough evidence to support a verdict on the second count there was enough to do so on the third and fourth counts.

Opinion

In view of what we have just said about the reserve, it is hardly necessary to discuss whether it was before or after October 18, that Costello received $66,000 which he returned as received in 1937 from Kastel's share in the Bayou Novelty Company; but in any event there was evidence enough to find that he did receive it before October 18. The Bayou company was a partnership between one, Kastel, and another man who died on June 19, 1937; and Costello had a half interest in Kastel's share, which turned out to be about $132,000. Although Costello's return does not show whether he received his half before or after October 18, all of Kastel's share was in Kastel's hands by June 26, because that was the balance of his account on that day after deducting that sum; and Costello testified that Kastel remitted to him "weekly, sometimes monthly." This established, prima facie, that Costello had received before October 18 the share that he entered in his income tax return.

The second point raised is the judge's refusal to allow Costello to put in evidence assessments by the Tax Bureau of deficiencies in his net income tax as reported for the years 1941-1945. These he offered to meet the prosecution's evidence that he had no concealed cash reserve on January 1, 1946. They showed, he argues, that his "net income," as "corrected," had been larger by $292,000 than what he had reported, which was $90,000 more of unreported net income in the five years; 1941-1945, than, according to the prosecution's computation, he had had of unreported gross income in the eight years, 1938-1945. From this, he argues, the jury might have found that he had had, or at least might have had, a concealed cash reserve on January 1, 1946, which would have been enough to meet the purchases during the "indictment years." Judge McGohey heard prolonged argument as to the relevancy of these assessments, and finally excluded them be-

cause he thought that, unaccompanied as they were by any explanation, they were more likely to mislead than to enlighten the jury. Costello did not suggest that he meant to supplement the assessments by showing how much of the alleged unreported net income had been spent for consumable purchases, or how much remained, or might have remained, as a concealed cash reserve on January 1, 1946. He stood upon their admissibility as they read.

We shall assume, arguendo, that the assessments were competent evidence on this trial that Costello had received the net income that they charged him with failing to report. We do not indeed agree that they were "judgments" which estopped the prosecution, for they were not.* It has been recognized practice for centuries to levy on tax assessments;** but the taxpayer has always been allowed to challenge their validity in one way or another, or to recover his money from the collector. Nevertheless, the assessments rested upon findings of the Tax Bureau made under its statutory authority, and we will assume, again arguendo, that as such, they were competent as admissions against the prosecution in a criminal trial, although the point is not free from doubt. If they were competent, they were relevant to show that Costello had received $90,000 of unreported net income more than the prosecution had succeeded in proving that he had received of unreported gross income during the eight years before January 1, 1946. That could, indeed, have been one link in a chain of reasoning to prove that he might have had a cash reserve in his hands on January 1, 1946; but it would be only a link, and it proved nothing, unless accompanied by

* *Bonwit* v. *Helvering*, 137 Fed. (2) 537 (C. A. 2); *Commissioner* v. *Mellon*, 184 Fed. (2) 157 (C. A. 3).

** *Murry* v. *Hoboken Land and Improvement Company*, 18 How. 272.

evidence as to what had been done with the income so received. So far as Costello or his wife might have spent it for consumable goods, or have otherwise disposed of it, it could not be part of a cash reserve; and there was no presumption that they had not so spent it. It is hornbook law that, although a party may offer evidence rationally relevant to the issue, that does not inevitably make it admissible. It may, just as Judge McGohey thought in this instance, tend rather to mislead than to enlighten the jury.* When the prosecution showed the amount of his gross income during the eight years, it did so by proving in detail the purposes for which he spent his money, and thus supplied just the element that was missing from the assessments. It was certainly within the judge's discretion to decide whether to admit them until this omission was supplied; and we are in entire accord with his ruling.

The third point is that it was error to allow the jury to include Mrs. Costello's purchases as having been made out of Costello's money. We have already stated the evidence that supports such an inference; and we think that it was sufficient, standing uncontradicted as it did. In this connection the question arises whether it was an added ground for this conclusion that she was not called as a witness for the defence, a wife now being a competent witness in her husband's favor.** In a case where the wife was not herself concerned in the transaction that was being prosecuted as a crime, we held that it was permissible to infer from the husband's failure to call her

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* *Golden Reward Mining Co.* v. *Buxton Mining Company*, 97 Fed. Rep. 413, 416 (C. C. A. 8);
New England Trust Co. v. *Farr*, 57 Fed. (2) 103, 110 (C. C. A. 1);
Thayer: "Evidence at the Common Law" pp. 516, 517;
Wigmore, § 1864.

** *Funk* v. *United States*, 290 U. S. 371.

that her evidence would not be favorable;* but when, as here, she was a party to the transaction and might believe herself to be subject to prosecution, the inference becomes much weaker, if indeed it does not altogether disappear. In that situation she might wish to claim a personal privilege against self incrimination, even though she were not in fact criminally involved. On the whole it appears to us therefore that no such inference should be drawn in the case at bar; and it is not necessary to decide the point, for there was evidence enough without it, as we have said; and the question was not raised at the trial.

The fourth point is that the judge admitted some evidence that was not adequately connected with Costello, and did not confine the prosecution to the same amounts of unreported gross income that it had alleged in a bill of particulars. The evidence whose admission is complained of consisted of five items, appearing in the prosecution's computation for the "indictment years"; their aggregate is about $29,000, about $20,000 of which was entered as spent in the year 1949. For that year the prosecution computed an unreported net income of $32,500, and as has already appeared, even a cash reserve of $73,000 on January 1, 1946, would have been exhausted by January 1, 1949. Thus, it would make no difference as to the fourth count even though these items of income had been omitted. We do not mean by this that they were not adequately proved; but it is not necessary to discuss them. The $9000 entered in the earlier years was for about $1500 for travel expenses, $4400 for a Cadillac motor, and $3000, the initial payment on a mausoleum. The travel expenses were proved by testimony of the railway fares to and from places that Costello had visited; and the objection is frivolous. Judge McGohey heard extended ar

* *United States* v. *Fox*, 97 Fed. (2) 913 (C. A. 2).

gument about the motor car, and, although the proof did not amount to demonstration, it is apparent that every reasonable inference pointed to its purchase for Mrs. Costello. As to the payment on the mausoleum, the testimony of Festa, who signed the contract, was that he called up some one whom he supposed to be Costello and said that the payment was necessary. His interlocutor agreed and soon thereafter he received $3000 in $100 bills with which he made the payment. The mausoleum was for Costello, and the suggestion that some one else might have paid for it, does not deserve serious answer. Finally, although it is true that the prosecution proved about $44,000 more of unreported gross income than the total—$244,000—which it had alleged in the bill of particulars, that was a variance that could not have prejudiced the defence. Indeed, that was not suggested at the trial. We have long since passed the time when a trial has to be conducted with the formality of the code duello; §52 (a) of the Rules of Criminal Procedure directs us to "disregard" any "variance" that "does not affect substantial rights."*

The fifth point is that the judge's charge was inadequate. In *Holland* v. *United States* the Supreme Court said that in "net worth" prosecutions "charges should be especially clear, including, in addition to the formal instructions, a summary of the nature of the net worth method, the assumptions on which it rests, and the inferences available both for and against the accused." In the margin we have put those portions of Judge McGohey's charge that cover this feature of the case,** and we can

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* *Berger* v. *United States*, 295 U. S. 78, 81; *United States* v. *Kahen*, 314 U. S. 513, 526.

** "This method involves determination of the defendant's net worth at the beginning and end of a period in order to foreclose the possibility that the expenditures were made, or the net worth increases were derived, from prior accumulated funds.

find nothing omitted that would have added to the enlightenment of the jury. It is unnecessary to discuss the refusals to charge. We understand the defence also to raise the point that the acquittal on the first count was inconsistent with the conviction on the other three. That is not true in fact, as has already appeared; but the point is

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"The underlying theory is that if the expenditures, together with any changes in net worth, exceeded the reported income in the period, the inference may be drawn that the defendant's total income was not properly reported.

"You will note that I have said that an inference may be drawn. I don't mean thereby to suggest that you should draw an inference or that you should not draw it. It is for you alone to draw such inferences as you think the evidence rationally supports.

"It is obvious, I think, that under this theory, the net worth of the defendant as of January 1, 1946, January 1, 1947, January 1, 1948, and January 1, 1949, which are the prosecution years, must be fixed with reasonable accuracy." Again: "The Government has undertaken to fix the starting point as of October 18, 1937, and its calculations of the defendant's unreported income are based upon the assumption that the opening net worth accounts for all the resources of the defendant and his wife at that time, but it is for you to determine whether all the resources of the defendant and his wife as of October 18, 1937, and in each of the prosecution years, have in fact been included in the opening net worth for each of those years. * * *

"If you find that the evidence does not establish the fixed starting point with reasonable accuracy, then all the calculations based on that starting point would be in error.

"If you find such errors to exist, it is for you to determine what effect, if any, such error has on the ultimate figure of additional taxable income computed for any of the prosecution years."

Again: "In order for you to find that sums received by the defendant during any of the taxable years constituted income to him, it is not necessary for the Government to have proved the exact source of the income.

"None of the alleged excess investments and expenditures made by the Costellos during any year shall be considered in

ill taken in any event, for rational consistency between the verdicts of a jury is never necessary.*

The last point is that the grand jury had no competent evidence at the inquest on which to find the indictment; and that for this reason it should have been dismissed. During the trial Costello's counsel asked each of the witnesses for the prosecution, whether he had appeared before the grand jury, and only three had done so. Those who had appeared had had no personal acquaintance with Costello or his affairs; they were accountants or experts and we find it impossible to escape the conclusion that their computations must have been based on hearsay. On this showing at the close of the prosecution's evidence and again at the close of all the evidence, Costello moved to dismiss the indictment. He had pleaded not guilty in April 1953, and in February, 1954, he obtained an order to show cause from Judge Weinfeld for an inspection of the minutes of the grand jury, and to dismiss the indictment because "there was no lawful evidence" to support it. In

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determining the taxable income of the defendant Frank Costello in any year unless you find that there was an excess of expenditures and investments, and that it constituted money which the defendant received as taxable income during the year in which the money was spent."

Again: "One of the theories of the defense here, of course, is that the purchases made by Mrs. Costello were in her name and were actually made with her money rather than with money supplied by the defendant, but it is for you to decide whose money was actually spent in these expenditures and investments by Mrs. Costello or in her name.

"The fact that a person has spent a considerable amount of money does not prove that he owed an income tax on that amount, nor does the fact that the money was deposited in a bank prove that such money was liable for income tax."

* *Dunn v. United States*, 284 U. S. 390.
United States v. Dotterweich, 320 U. S. 277.

support of this order he filed an affidavit asserting his innocence, and that he was "firmly convinced that there could be no legal or competent evidence before the Grand Jury," because he had always reported his full income. On return of the order Judge Weinfeld denied the motion, and we do not understand that the defence asserts that in so doing he was wrong; at any rate he was plainly right. Rule 12 (b) (3) of the Rules of Criminal Procedure provides that such a "motion shall be made before the plea is entered," but that "the court may permit it to be made within a reasonable time thereafter"; and subdivision 4 of Rule 12 (b) provides that, although it "shall be determined before trial," the hearing upon it may "be deferred for determination at the trial of the general issue." Perhaps, in the light of this, it would be permissible to dispose of the denials of the motions made at the close of the prosecution's case and of the whole case, by saying that they should not be reviewed because Costello had failed to ask Judge Weinfeld to defer their determination until "the trial of the general issue." It seems to us that, especially in a prosecution so jealously circumscribed as this, we ought not to dispose of a point going to the very heart of it upon such a formal and harsh ground. Costello had done all he could to raise the point; and, since he was without that not uncommon help that the names of witnesses called at the inquest must be endorsed upon the indictment,* he was stripped of all means of showing that the whole proceeding had no lawful beginning, unless the course he adopted was left open. We cannot accept it that such a trivial omission or slip in procedure should have such a decisive consequence; and we hold that we may not escape deciding whether it is ground for dismissing an

* *Goodman* v. *United States*, 70 Fed. (2) 741 (C. A. D. C.).

indictment that all the evidence adduced at the inquest was hearsay.

It is indeed well settled that the admission of incompetent evidence at the inquest is not a ground for dismissing the indictment;* but at times the courts have assumed that it is otherwise, if all the evidence is incompetent. In *Nanfito* v. *United States*, 20 Fed. (2) 376, 378 (C. C. A. 8) and *Brady* v. *United States*, 24 Fed. (2) 405, 407 (C. C. A. 8), that was made the basis of the decision, and Judge Phillips declared in the second of these cases that it was "the settled law" in the Eighth Circuit; but we have found no other federal appellate decisions which can be said to have actually turned upon the point. If "incompetent" is to cover all evidence, however rationally persuasive it may be, that would be excluded at a trial with great deference we cannot agree. Legal rules presuppose that the occasions to which they apply, shall be decided under the ordinary postulates of reasoning; and the exclusory rules are an exception, for they apply to evidence that is relevant rationally, but that courts will not accept, not because it does not prove the issue, but because it is thought unjust to the opposite party to use it against him, or because it is within some privilege to suppress the truth. We should be the first to agree that, if it appeared that no evidence had been offered that rationally established the facts, the indictment ought to be quashed; because then the grand jury would have in substance ab-

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* *Holt* v. *United States*, 218 U. S. 245, 248;
McGregor v. *United States*, 134 Fed. Rep. 187, 193 (C. C. A. 4);
Chadwick v. *United States*, 141 Fed. Rep. 225, 235 (C. C. A. 6);
McKinney v. *United States*, 199 Fed. Rep. 25, 28 (C. C. A. 8);
Anderson v. *United States*, 273 Fed. Rep. 20, 29 (C. C. A. 8);
Murdick v. *United States*, 15 Fed. (2) 965, 967 (C. C. A. 8);
Olmstead v. *United States*, 19 Fed. (2) 842, 845 (C. C. A. 9);
Kastel v. *United States*, 23 Fed. (2) 156, 158 (C. C. A. 2);
Cox v. *Vaught*, 52 Fed. (2) 562 (C. C. A. 10).

dicated. But that is in no sense true of hearsay, as is shown both by the numerous exceptions, based upon the inaccessibility of any better evidence, and by decisions that have again and again held that it may be as dependable a reliance at a trial as any other evidence; the only condition upon its use being that the opposite party shall not object to it.* Indeed, we conduct our most serious affairs upon the strength of it; it would be impossible to carry on a day's business without it.

The resulting situation: that is, that hearsay will serve, only when supplemented by some modicum of first-hand evidence, has nothing to commend it. The reason why evidence, incompetent for any reason, will ordinarily upset the judgment is that, except in rare cases, it is impossible to know how far it may have determined the judgment; yet it is obviously just as impossible at an inquest as at a trial to know that if was not the hearsay alone that convinced the jurors. We make no effort, and can make none, to ascertain what part it may have played in the result; all we can do, if hearsay alone is not to be enough, is to insist that there must be some first-hand evidence, no matter how feeble and untrustworthy the jury may have thought it. We can see no justification for such an amorphous compromise; and it is particularly unsatisfactory in a unilateral investigation like an inquest. Apparently the notion persisted down into the 18th Cen-

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* *Schlemmer* v. *Buffalo, Rochester & P. Ry.*, 205 U. S. 1, 8, 9;
Diaz v. *United States*, 223 U. S. 442, 450;
Rowland v. *St. Louis & San Francisco*, 244 U. S. 106, 108;
Spiller v. *Atchison, Topeka & Santa Fe*, 253 U. S. 117, 130;
Clark v. *McNeill*, 25 Fed. (2) 247, 249 (C. C. A. 6);
Continental Ins. Co. v. *Fortner*, 25 Fed. (2) 398, 402 (C. C. A. 6);
Dowling v. *Jones*, 67 Fed. (2) 537, 539 (C. C. A. 2);
United States v. *Rosenberg*, 195 Fed. (2) 583, 596 (C. A. 2);
Calmar S. S. Co. v. *Scott*, 197 Fed. (2) 795, 798 (C. A. 2).

tury that the objection to hearsay was that it allowed disputes to be "tried" otherwise than by oath;* but already in the 17th Century it had been held that the reason against accepting depositions was that "the defendant not being present when they were taken before the mayor, and so had lost the benefit of cross-examination."** "As our system changed in character from investigative to adversary the rule rejecting hearsay and the rule making opportunity for cross-examination a requisite of admissibility developed side by side. * * * Consequently, not the jury system, but rather the adversary theory of litigation, coupled with the then currently accepted notions as to the value of the oath, accounts for the hearsay rule as it was at the opening of the nineteenth century."*** So far as the right of cross-examination is its sanction, first-hand evidence would be as inadmissible at an inquest as hearsay; and a refusal to recognize it as sufficient proves too much: for the accused is normally not present at an inquest and cannot cross-examine. True, there is no doubt some warrant of reliability in an oath, and more in the opportunity to observe the witness; and both are absent in the case of hearsay; but so far as these may be deemed to count, they should have excluded it altogether, which, as we have seen, they do not do. The excuse no doubt is that the stake is not the accused's guilt but only the burden of the risk and expense of a trial; but why should it be thought that that burden is perceptibly lightened by the requirement that any bit of added first-hand evidence will be enough, be it ever so little persuasive? Surely that is in practice an utterly illusory protection; and often would lead, as it would have here, to a monu-

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* Baron Gilbert's Law of Evidence, 152.

** *Rex* v. *Paine*, 5 Mod. 163, 165.

*** Morgan, Model Code of Evidence, A. L. I. pp. 220, 221.

mental obstacle and expense to the prosecution of crime. We will not add one more count to Professor Morgan's indictment of the whole subject: "The fact is, then that the law governing hearsay to-day is a conglomeration of inconsistencies, developed as a result of conflicting theories. Refinements and qualifications within the exceptions only add to its irrationality. The courts by multiplying exceptions reveal their conviction that relevant hearsay evidence has real probative value, and is capable of valuation by a jury as well as by other triers of fact." * Consider also what another acknowledged master of the subject says, Dean Wigmore. "But suppose that there is a limitation of the grand jury's sources of investigation in the shape of a rule that they may receive only such kinds of evidence as would be receivable on a trial before a petit jury. Such a rule is a plain obstruction of justice, reprehensible in policy. * * * In the grand jury's proceedings, if the rule is to be enforced at all, as it is for petit juries, the fact must be allowed to be shown by the grand jurors or others present. If, then, any community is willing to accept so deleterious a rule of criminal procedure, its enforcement in the only feasible way must be permitted by showing the facts." **

The question is still undecided by the Supreme Court, and in this circuit we are uncommitted except for an old decision of Wallace, *J.*, in a ruling as district judge, which he confined to "extreme cases, when the court can see that the finding of a grand jury is based upon such utterly insufficient evidence, or such palpably incompetent evidence, as to indicate that the indictment resulted from prejudice,

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* Loc. cit. pp. 223, 224.

** Wigmore, §2364 (a).

it was found in wilful disregard of the rights of the accused." * We hold that it is immaterial that only hearsay was adduced at the inquest in support of the allegations of the indictment and it follows that although the conviction on the second count will be reversed, that on the third and fourth counts will be affirmed.

Judgment on the second count reversed; judgment on the third and fourth counts affirmed.

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* *United States* v. *Farrington*, 5 Fed. Rep. 343, 348. Compare: *United States* v. *Violon*, 173 Fed. Rep. 501; *United States* v. *Morse*, 292 Fed. Rep. 273, 278; *United States* v. *Garsson*, 291 Fed. Rep. 646.

Concurring Opinion by Frank, *C.J.*

FRANK, *Circuit Judge*, concurring:

1. Judge Hand finds that the sole evidence before the grand jury was hearsay. Accordingly, we do not have a case where, in addition to hearsay, there was other evidence of an unimpeachable character. Judge Hand holds that, nevertheless, the indictment cannot be questioned. This leaves me in some doubt.

I entirely agree that the hearsay rule is undesirable. I think it would be well if the rule were revised so that, at a trial, the question of its admissibility would be left to the discretion of the trial judge. But, although courts may make desirable modifications of many of the exclusionary evidence rules, I think that the hearsay rule is so well established and so highly cherished by the Bar and the judiciary generally, that very deep inroads on that particular rule should be left to the legislature.[1]

Here we have a grand jury returning an indictment on the basis of no evidence which, over the objection of defendant, could properly be received at a trial. Of course, at the trial such evidence would be admissible, and a proper basis for verdict and judgment, if the defendant did not then object. But, until he waives its inadmissibility by failure to object, it is incompetent; and, of course, he is in no position to object to evidence presented to a grand jury. Consequently, I have very serious misgivings about concurring in a conclusion that a grand jury may indict solely on the basis of evidence that would not support a verdict after trial.[2] However, because of my esteem

1. *Hoffman* v. *Palmer*, 129 F. (2d) 976, 987 (C. A. 2); *Slifka* v. *Johnson*, 161 F. (2d) 467, 470 (C. A. 2).

2. See, *e.g.*, *United States* v. *Kilpatrick*, 16 Fed. 765, 772; *United States* v. *Rubin*, 218 F. 245, 248 (quoting Mr. Justice Field); *United States* v. *Bolles*, 209 Fed. 682; *Brady* v. *United States*, 24 F. (2d) 405, 407-408 (C. A. 8); *Nanfito* v. *United States*, 20 F. (2d) 376, 378 (C. A. 8).

for Judge Hand's wisdom, I reluctantly concur, with the hope that the Supreme Court will review our decision and consider the question.

2. We have often held in cases cited by Judge Hand—among them some in which I have joined or indeed written the opinions—that, as Judge Hand puts it, "the prosecution makes out a sufficient case to go to the jury, if the evidence would have been enough in a civil action." We have also held—*United States* v. *Valenti*, 134 F. (2d) 362, 364 (C. A. 2)—that the jury need not apply the reasonable-doubt criterion "to each chain in the proof," and that this test "operates on the whole case and not on separate bits of evidence each of which need not be so proven." Other courts have held otherwise, or have used expressions, with varying degrees of emphasis, at variance with ours.[3] And very recently the Supreme Court, in a "net worth" case like this, admonished us that "the prosecution

3. See, *e.g.*, *Nanfito* v. *United States*, 20 F. (2d) 376, 379 (C. A. 8); *Egan* v. *United States*, 287 F. 958, 967 (C. A. D. C.); *United States* v. *Morley*, 99 F. (2d) 683, 685 (C. A. 7); *United States* v. *Dried Fruit Association of California*, 4 F. R. D. 1, 5 (D. C. N. D. Calif.); *State* v. *Gutheil*, 98 P. (2d) 943, 944 (Utah); *People* v. *Kovacevich*, 65 P. (2d) 807, 809 (Calif.); *State* v. *Newman*, 127 Conn. 398, 17 Atl. (2d) 774, 775. See, also, numerous expressions that a trial court must direct a verdict for the defendant if the substantial evidence is as consistent with the defendant's innocence as with his guilt, *Parnell* v. *United States*, 64 F. (2d) 324, 329 (C. A. 10); *United States* v. *Matsinger*, 101 F. (2d) 1014, 1016 (C. A. 3); *Candler* v. *United States*, 146 F. (2d) 424, 426 (C. A. 5); *Isbell* v. *United States*, 227 Fed. 788, 792 (C. A. 8); or that a trial court must direct a verdict for the defendant unless the evidence excludes every other hypothesis but that of guilt, *Isbell* v. *United States*, *supra*; *United States* v. *Maghnang*, 111 F. Supp. 760, 761-762 (D. C. Dela.); *Paul* v. *United States*, 79 F. (2d) 561, 563 (C. A. 3); *United States* v. *Maryland & Virginia Milk Pro. Association*, 90 F. Supp. 681 (D. C. D. C.). Cf. *United States* v. *Feinberg*, 140 F. (2d) 592 (C. A. 2); *United States* v. *Valenti*, 134 F. (2d) 362 (C. A. 2).

must prove every element of the offense beyond a reasonable doubt though not to a mathematical certainty." *Holland* v. *United States*, 348 U. S. 121, 138. Although, then, I concur in Judge Hand's opinion, I think it desirable that the Supreme Court consider the application of that ruling here.

Judgment

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 5th day of April, one thousand nine hundred and fifty-five.

Present:

HON. CHARLES E. CLARK,
Chief Judge,
HON. LEARNED HAND,
HON. JEROME N. FRANK,
Circuit Judges.

UNITED STATES,
Plaintiff-Appellee,

—v.—

FRANK COSTELLO,
Defendant-Appellant.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

Judgment

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that on the second count the judgment of said District Court be and it hereby is reversed; and on the third and fourth counts said judgment be and it hereby is affirmed.

It is further ordered that a Mandate issue to the said District Court in accordance with this decree.

A. DANIEL FUSARO
Clerk